III. Cost Finding Methodology. TDMHMR adjusts reported cost data in order to ensure that allowed historical costs are reasonable and necessary and that projected costs take into account reasonable anticipations of prevailing economic conditions during the prospective rate period.

A. Cost determination by Cost Centers. TDMHMR combines reported expenses into two cost centers for community-based providers and five cost areas for state-operated facilities. The cost centers for community-based providers vary by type of provider service.

1. Cost Centers for large ICF/MR V and large ICF/MR VI community-based provider services.
   a. Resident Care Cost Center. The resident care cost center includes all direct resident care expenses: nursing care, durable medical equipment, consultant, social service, activity, training, laundry, and housekeeping expenses.
   b. All Other Cost Center. The all other cost center combines dietary care cost (i.e., food; food service, dietary consultant services), facility costs (all expenses necessary to operate and maintain the facility); and administrative costs (administrative salaries, supplies, and interest on working capital loans).
2. Cost Centers for ICF/MR I, Small ICF/MR V, and Small ICF/MR VI provider services.
   a. Labor Cost Center. The labor cost center includes all staff salaries and wages for persons working at the facility regardless of the function of those staff, central office salaries and wages and all consultant and contracted expenses.
   b. All Other Cost Center. The all other cost center is comprised of all expenses not included in the labor cost center.
3. State-operated Cost Center.
   a. Resident Care Cost Center. The resident care cost center includes all direct care expenses: nursing care, durable medical equipment, consultant, social service, activity, training, laundry, and housekeeping expenses.
   b. Dietary Care Cost Center. The dietary care cost center includes food, food service, and dietary consultant expenses.
   c. Facility Cost Center. The facility cost center includes expenses to operate and maintain the buildings, equipment, and capital necessary to provide resident care.

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regulations.

2. **Direct service costs.** Direct service costs include costs associated with personnel who provide direct hands-on support for consumers and include personnel such as direct care workers, direct care worker supervisors, QMRP's, Registered Nurses, Licensed Vocational Nurses, and other personnel who provide activities of daily living training and clinical program services. Reporting of direct service costs includes: costs related to wage rates, benefits, contracts for direct services, staffing levels, and direct service supervision information.
3. **Generally Accepted Accounting Principles** (GAAP). Unless otherwise specified, reports should be prepared consistent with generally accepted accounting principles (GAAP) which are those principles approved by the American Institute of Public Accountants (AICPA). Internal Revenue Service (IRS) laws and regulations do not necessarily apply in the preparation of the cost report. The allowability of costs included in cost reports are specified in Section III.B. of Attachment 4.19-D (ICF/MR). The methods outlined in the state plan take precedence for provider cost reporting purposes.
4. **Indirect costs.** Those shared costs which benefit, or contribute to, the operation of providing ICF/MR services, other business components, or the overall entity with which the TDMHMR has a provider agreement. Indirect costs must be allocated, directly or as a pool of costs, across those business components sharing in the benefits of those costs.
5. **Model-Based Rates.** The model-based rates are the rates for non-state operated providers as determined by the processes outlined in Section V.B. of Attachment 4.19-D (ICF/MR).
6. **Person.** An individual, partnership, corporation, association, governmental subdivision or agency, or a public or private organization of any character.
7. **Provider.** Any entity with whom TDMHMR has a provider agreement.
8. **Provider agreement.** Any written agreement that obligates TDMHMR to pay money to a person for goods or services under the Title XIX Medical Assistance

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9. **Rebase.** The revision to the underlying assumptions on which the modeled rates are calculated, including revisions to staffing ratios, pay structure, the composition of direct care staff, or other cost factors used in the formula for modeling the rates.
10. **State-operated facility.** An ICF/MR for which TDMHMR is the provider.
11. **Non-state operated facility.** An ICF/MR that is not under the direct control of TDMHMR. This includes both private providers and providers affiliated with the local public mental health and mental retardation center.
12. **Related Party.** Two or more individuals or organizations constitute related parties whenever they are affiliated or associated in a manner that entails some degree of legal control or practical influence of one over the other.
13. **Unallowable costs.** Expenses that are not reasonable or necessary for the provision of ICF/MR services.

III. Allowable and Unallowable Costs

A. **General principles.** Allowable and unallowable costs, both direct and indirect, identify expenses which are reasonable and necessary to provide ICF/MR services and are consistent with federal and state laws and regulations. The primary determinant of allowability is whether or not the cost is consistent with the criteria set forth in GAAP and federal circular OMB A-87, Attachment B. This circular is not comprehensive, and the failure to identify a particular cost does not necessarily mean that the cost is an allowable or unallowable cost.

B. **Specifications for allowable and unallowable costs.** The primary criteria of allowability is whether or not the cost meets the definitions as set forth in the federal circular OMB A-87, Attachment B. Except where specific exceptions are noted, the allowability of all costs is subject to the general principles in circular OMB A-87, Attachment B. The following are exceptions, or elaborations, to circular OMB A-87, Attachment B:

1. **Accounting and audit fees.** Except for Schedule C or Partnership tax returns related to an ICF/MR provider, expenses for preparation of personal tax

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IV. A Continued

3. A temporary method will be used to determine the reimbursement rates for selected ICF/MR community-based facilities. This method will be in effect until formally replaced or modified through a state plan amendment.

   a. Eligible facilities(as specified in I. B.) are as follows:
      (1) Community-based Level I facilities;
      (2) Large community-based Level V facilities;
      (3) Large community-based Level VI facilities;
      (4) Small community-based Level V facilities;
      (5) Small community-based Level VI facilities; and
      (6) Community-based Level VIII facilities (ICF/MR/RC).

   b. The ICF/MR/RC, Level VIII reimbursement rate is intended to capture the standard costs of providing care and active treatment in a comparable six bed facility. Compilation of the base rate may be found in IV(C).

   c. For the facilities listed in paragraph 3.a.(1)-(6) of this subsection, reimbursement rates for calendar year 1996 will be determined by inflating the reimbursement rates in effect for January 1, 1995, by an inflation factor of 2.75%. For subsequent calendar years, rates will be determined as described in Section IV.A.1. and IV.A.2.

      The 2.75% inflation factor was derived by the following:

      Published rules and the Medicaid state plan identify the Implicit Price Deflator for Personal Consumption Expenditures (IPD-PCE) as a measure of general cost inflation used in determining rates for numerous Texas Medicaid services, either in conjunction with or as a substitute for other inflation indices. The most recent IPD-PCE forecast available from Data Resources, Inc. (DRI) in October 1995 was an average annual rate of increase of 2.3% in 1996, as compared to 1995. The IPD-PCE inflation measure is referenced under III.D. on page 4 in Attachment 4.19-D of the state plan.

      The proposed 1996 forecast of the Skilled Nursing Facility (SNF) Input Price Index was 3.4% for CY 1996.

      A composite index was developed based upon a 60:40 weighting of the IPD-PCE and HCFA SNF Input Price Index, respectively. The resulting inflation adjustment factor of 2.75% for CY 1996 over CY 1995 should adequately represent the mixture of cost increases for medical and other professional staff, paraprofessional staff, supplies, equipment, and property-related items in the ICF/MR program.

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The TDMHMR Board will evaluate financial and statistical information derived from the cost reports and determine a reimbursement rate which will reasonably reimburse the cost of an economic and efficient provider.

The TDMHMR Board will determine the reimbursement rate in an open meeting. Representatives of providers will be advised of the recommended rates and will be given the opportunity to present testimony to the Board.

After consideration of the financial and statistical information and all public testimony, the Board will set rates which, in its opinion, will (1) be within budgetary constraints; (2) be adequate to reimburse the cost of operations for an efficient and economic provider; and (3) be justifiable given current economic conditions.

B. Classes of Service and Provider Type. Reimbursement rates are determined separately by level of care and facility size within each provider type.

C. Experimental class. TDMHMR defines an experimental class of service to be used to conduct research and demonstration projects on new reimbursement methods. The methodology for the experimental class of service is defined for each project. The experimental class is not used, however, unless the TDMHMR Board and the Health Care Financing Administration (HCFA) have approved the experimental methodology.

1. ICF/MR/RC VIII Facility Class. TDMHMR defines community-based facilities that are certified as Intermediate Care Facilities for the Mentally Retarded/Related Conditions (ICF/MR/RC) VIII and that have no more than six Medicaid contracted beds as an experimental class.

   a. Effective May 1, 1996, facilities in the ICF/MR/RC class receive per diem rates based on level V small facility rates for operation of facilities in this class. TDMHMR staff developed rates for this class of providers using the level V small facility base rate because of a lack of cost report information about the cost of client care by this class of provider. The level V small facility rates are the most comparable to the services provided to this population. TDMHMR staff developed rates based on this base rate and add-on amounts. The add-on amounts target specific client characteristics that are known to require additional facility space, equipment, staffing intensity, or professional staff time.

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Costs for additional facility space or equipment are derived from the median cost reported on the most recently submitted ICF/MR provider fiscal year cost reports. Additional staffing costs are estimated from the most recent ICF/MR wage and hour survey. Wage and hour information is collected at least annually in the ICF/MR provider fiscal year cost report. Wage and hour surveys, other than those collected in the cost report, may be used. As specified in Section III(D), cost from wage and hour surveys and cost reports are projected from the cost report or wage and hour survey base period to the rate period. The base rate is intended to capture the standard costs of providing care and active treatment in a comparable six bed facility. For reasons noted in (b) below, the base rate was comprised of the small facility ICF/MR V rate and estimated additional costs for augmentative communication devices . The devices help an individual carry on a conversation and make basic needs known. The devices include, but are not limited to, personal computers, communication boards, speech synthesizers, and communication software packages. The base rate and add-ons were developed in close consultation with clinical staff of the Texas Department of Mental Health and Mental Retardation and other professionals experienced in direct service delivery and program monitoring.

b. The TDMHMR Board revises ICF/MR/RC rates at least annually based on anticipated cost increases. The Board continues to set rates for this class in the manner described in Section IV(C)(1)(a), because the array of costs vary widely in this class and the size of the data-base is so small that these variances skew the data. The base rate is sufficient to cover costs incurred by a economic and efficient provider and the add-ons cover the costs of serving persons who have more intense service needs. Cost reports of ICF/MR/RC VIII providers are not included in the data base for determining rates for other community-based providers.

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c. The base rate and add-on rates are uniform statewide rates. Payment rates vary by clients, based on their eligibility for add-ons.

D. Rate Determination for State-operated Facilities. The Texas Mental Health and Mental Retardation Board determines reimbursement annually. State-operated facility rates are effective May 1, 1996. Rates are facility-specific, determined prospectively (with the inflators outlined in Section III D.), cost related, and do not vary by size or level of care.

1. Description of rate class. The state-operated facility rate class consists of all ICF/MR facilities that are operated by TDMHMR.

2. Determination of state-operated facility rates. Eligible state-operated facilities are reimbursed in the following manner:

a. The rate for each facility's projected per diem cost is based on the total projected allowable costs for selected cost centers divided by the total days of service the facility delivered in the cost reporting period.

(1) Rates for state-operated ICFs/MR are based on the most current available cost report.

(2) Rates for newly certified facilities that have not operated long enough to have current available cost reports (as defined in section IV D 2 A(2) (b)) will be based on a pro forma model. The model will be derived as follows:

A six bed or less state-operated facility's rate will be the average of all available similarly sized state-operated facilities per diem rates for that particular rate year. After the first 90 days of operation, when facilities have a sufficient number of days of service to represent incurred operational costs, they will be required to submit three month cost reports. Per diem reimbursements that are based on the costs incurred in the first quarter of operation will be set within six months of each facility's certification. Each facility will be operating on its historical costs within 6 months of certification as outlined in 2a. above.

b. Since provision is made to ensure that reasonable and necessary costs are covered, state-operated ICF/MR facilities do not qualify for additional supplemental reimbursement for individuals whose needs require a significantly greater than normal amount of care.

c. Cost reports from facilities in this class will not be included in the cost arrays that are used to determine reimbursement rates for other classes of providers.

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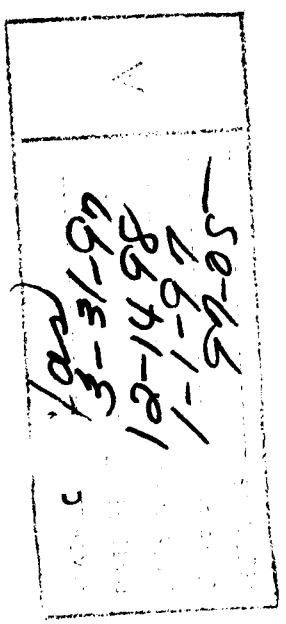
returns, and production and/or distribution of annual reports for stockholders or investors are not allowable. Expenses for the preparation of audit/management reports for use by management staff or board members in directing or managing provider operations are allowable.

2. **Legal expenses.** Legal retainers are not allowable in and of themselves. Legal costs associated with the provision of ICF/MR services are allowable. Legal costs associated with litigation between the provider and a governmental entity are unallowable. Legal costs associated with any other unallowable cost are also unallowable.

3. **Depreciation and use allowances/equipment and other capital expenditures.** Purchases of equipment with an asset value at, or more than, $2,500 and an estimated useful life of more than one year must be depreciated or amortized, using the straight line method. In determining whether to expense or depreciate a purchased item, an ICF/MR provider may expense any single item costing less than $2,500 or having a useful life of one year or less. Depreciation and amortization expenses for unallowable assets and costs are also unallowable, including amounts in excess of those resulting from the straight line method, capitalized lease expenses in excess of actual lease payments, and goodwill or any excess above the actual value of physical assets at the time of purchase.

4. **Tax expense and credits.** Income taxes (federal, state and local) are not allowable. Taxes in connection with financing, refinancing, or refunding operations, such as taxes on the issuance of bonds, property transfers, issuance or transfer of stocks as a tax expense are unallowable. Expenses based on tax fines or tax penalties, and any associated interest, are not allowable.

5. **Grants, gifts, and income from the endowments and operating revenue.**
   (a) Grants and contracts from federal government such as transportation grants, United States Department of Agriculture grants, education grants, Housing and Urban Development grants, and Community Service Block grants, should be offset, prior to reporting on the cost report, against the particular cost or group of costs



Attachment 4.19-D
Reimbursement Methodology for
Intermediate Care Facilities for the Mentally Retarded

F. Expenses incurred by an ICF-MR facility in the documentation of dental services are reimbursed in the facility's vendor payment. The ICF-MR dental service component is reimbursed under the provisions of 4.19-B.

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G. Effective July 1, 1990, any reference to "private provider" in the Reimbursement Methodology for Intermediate Care Facilities for the Mentally Retarded (ICFs-MR) section of the Plan should be read as "community-based provider."

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